

Report of the auditor-general to the Northern Cape provincial legislature and the council on the Magareng Local Municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of the Magareng Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP) and the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), and the Division of Revenue Act, 2015 (Act No. 1 of 2015) (DORA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these separate financial statements based on my audit. I conducted my audit in accordance with the International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the separate financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the separate financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the separate financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the separate financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the separate financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Revenue from exchange transactions

6. I was unable to obtain sufficient appropriate audit evidence that management had properly accounted for service charges, due to the state of the accounting records. I was unable to confirm the service charges by alternative means. Consequently, I was unable to determine whether any adjustment to service charges, stated at R25 918 907 (2015: R25 702 200 in note 24 to the financial statements, was necessary.
7. During 2015, the municipality did not recognise revenue from exchange relating to service charges for water and electricity, in accordance with GRAP 9 *Revenue from exchange transactions* as not all meters were read. Revenue from exchange as well as receivables from exchange transactions was understated. I was not able to determine the full extent of the understatement of revenue from exchange relating to water and electricity and receivables from exchange as it was impracticable to do so.

Property, plant and equipment

8. The municipality did not record land and buildings in accordance with GRAP 17, *Property, plant and equipment*. The assumptions used in determining the value of land and buildings is not a fair reflection of the fair value. Consequently, land is understated and buildings overstated. I was unable to determine the full extent of the misstatement as it was impracticable to do so. Additionally, there was a resultant impact on depreciation, accumulated depreciation, the deficit for the period and the accumulated surplus.
9. The municipality did not record property, plant and equipment in accordance with GRAP 17, *Property, plant and equipment*, as the impairment assessment did not take all impairment indicators into account to determine the carrying value of property, plant and equipment relating to community assets as well as infrastructure for roads and storm water. Consequently, property, plant and equipment relating to these line items are overstated and impairment loss is understated. I was unable to determine the full extent of the overstatement and understatement as it was impracticable to do so. Additionally, there was a resultant impact on the deficit for the period and the accumulated surplus.

Receivables from exchange transactions

10. I was unable to obtain sufficient appropriate audit evidence for receivables from exchange transactions as the municipality did not have adequate systems to maintain records of receivables from exchange transactions. I was unable to confirm receivables from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustment to receivables from exchange transactions, stated at R3 568 339 (2015: R2 643 329) in note 13 to the financial statements, was necessary. Additionally, there was a resultant impact on accounts payable relating to debtors with credit balances.

Receivables from non-exchange transactions

11. During 2015, I was unable to obtain sufficient appropriate audit evidence for receivables from non-exchange transactions as the municipality did not have adequate systems to maintain records of receivables from non-exchange transactions. I was unable to confirm receivables from non-exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustment to receivables from non-exchange transactions, stated at R1 833 422 in note 11 to the financial statements, was necessary. My opinion on the current period's financial statements is also modified

because of the possible effect of this matter on the comparability of the current period's figures.

Irregular expenditure

12. In terms of section 125(d) of the MFMA, the municipality is required to disclose particulars of irregular expenditure in the notes to the annual financial statements. The municipality incurred expenditure in contravention of the supply chain management (SCM) requirements. This was not included in the irregular expenditure disclosed in note 49 to the financial statements. I was unable to determine the full extent of the understatement for the current as well as previous years as it was impracticable to do so.

Qualified opinion

13. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Magareng Local Municipality as at 30 June 2016 and its financial performance and cash flows for the year then ended, in accordance with the SA standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

14. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

15. As disclosed in note 42 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during 2016 in the financial statements of the Magareng Local Municipality at, and for the year ended, 30 June 2015.

Material losses and impairments

16. As disclosed in notes 11 and 13 to the financial statements, a significant provision for the impairment of receivables from non-exchange transactions and exchange transactions was made, which constitutes 92% and 97% of the total receivables from exchange transactions and non-exchange transactions balance respectively.
17. As disclosed in note 52 to the financial statements, material losses of R10 410 893 (2015: R7 197 186) and R9 141 172 (2015: R3 405 680) were incurred as a result of the distribution of electricity and water respectively.

Material underspending of the budget

18. As disclosed in the statement of comparison of budget and actual amounts, the municipality has materially underspent the budget on total expenditure by R36 728 461.

Financial sustainability

19. The financial statements indicate that the municipality incurred an increase net deficit of R10 816 960 (2015: R6 727 336) during the year ended 30 June 2016. This, along with the other matters as set forth in note 45, indicates the existence of a material uncertainty

that may cast significant doubt on the municipality's ability to operate as a going concern.

Unauthorised expenditure

20. As disclosed in note 47 to the financial statements, the municipality incurred unauthorised expenditure of R11 846 723 (2015: R35 168 896) mainly due to over expenditure on the budget. The total amount of unauthorised expenditure recorded in the annual financial statements at 30 June 2016 amount to R61 772 957 (2015: R49 926 234).

Fruitless and wasteful expenditure

21. As disclosed in note 48 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R2 997 945 (2015: R1 328 610) mainly due to interest and penalties for late payments. The total amount of fruitless and wasteful expenditure recorded in the annual financial statements at 30 June 2016 amount to R6 270 440 (2015: R3 272 495).

Additional matters

22. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unaudited supplementary schedules

23. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion on them.

Unaudited disclosure notes

24. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion on it.

Report on other legal and regulatory requirements

25. In accordance with the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected objectives presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

26. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected objectives presented in the annual performance report of the municipality for the year ended 30 June 2016:

- Key performance area 3: Basic service delivery and infrastructure development on pages x to x.

27. I evaluated the usefulness of the reported performance information to determine whether it was consistent with the planned objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for Managing Programme Performance Information (FMPPI).
28. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
29. The material findings in respect of the selected objectives are as follows:

Key performance area 3: Basic service delivery and infrastructure development

Usefulness of reported performance information

30. Section 41(c) of the Municipal Systems Act requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 100% of the reported objectives, indicators and targets were not consistent with those in the approved integrated development plan.
31. The FMPPI requires that performance targets should be specific, in clearly identifying the nature and required level of performance, and measurable. A total of 100% of the targets were not specific and measurable.
32. The FMPPI requires that performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use. A total of 100% of the indicators were not well defined.
33. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 100% of the indicators were not verifiable.

Reliability of reported performance information

34. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was because of limitations placed on the scope of our work due to the absence of information systems, the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information and the auditee's records not permitting the application of alternative audit procedures.

Additional matter

35. I draw attention to the following matters.

Achievement of planned targets

36. Refer to the annual performance report on pages x to x and x to x for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 25 to 34 of this report.

Unaudited supplementary schedules

37. The supplementary information set out on pages x to x does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report on them.

Compliance with legislation

38. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

39. The performance management system was not adopted by council as required by the Municipal planning and performance management regulation 8.
40. The performance management system and related controls were not maintained as it did not describe and represent the processes of performance monitoring, measurement, review, reporting and improvement, and how it is conducted, organised and managed, as required by section 38 of the Municipal Systems Act and regulation 7 of the Municipal Planning and Performance Management Regulations.
41. The service delivery and budget implementation plan (SDBIP) for implementing the municipality's delivery of municipal services and annual budget did not indicate projections for each month of the revenue to be collected, by source, and the operational and capital expenditure, by vote, as required by section 1 and 53(1)(c) of the MFMA.
42. Key performance indicators in respect of each of the objectives were not set out in the Integrated development Plan, as required by section 41(1)(a) of the Municipal Systems Act and regulations 1 and 9(1)(a) of the Municipal Planning and Performance Management Regulations.
43. Performance targets were not set for each of the key performance indicators for the financial year, as required by section 41(1)(b) of the Municipal Systems Act and regulation 12(1) and 12(2)(e) of the Municipal Planning and Performance Management Regulations.

Financial statements, performance and annual reports

44. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, liabilities and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records provided, but the uncorrected material

misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

45. The annual financial statements were not submitted for auditing within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.
46. The 2014-15 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.
47. The annual performance report for the year under review did not include the performance of the municipality and each external services provider, a comparison of the performance with set targets, and a comparison with the previous financial year and measures taken to improve performance, as required by section 46 (1)(a), (b) and (c) of the Municipal Systems Act.

Procurement and contract management

48. I could not obtain sufficient appropriate audit evidence that all contracts were awarded in accordance with the legislative requirements and a procurement process that is fair, equitable, transparent and competitive, as the sufficient internal controls was not implemented to ensure appropriate filing and retrieving of procurement documentation.
49. I could not obtain sufficient appropriate audit evidence that goods and services of a transaction value above R200 000 were procured by inviting competitive bids, as required by SCM regulation 19(a).
50. I could not obtain sufficient appropriate audit evidence that bid specifications were unbiased and allowed all potential suppliers to offer their goods or services, as required by SCM regulation 27(2)(a).
51. I could not obtain sufficient appropriate audit evidence that invitations for competitive bidding were advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2).
52. Bid adjudication committees were not always composed in accordance with SCM regulation 29(2).
53. I could not obtain sufficient appropriate audit evidence that bid adjudication committees were always composed in accordance with SCM regulation 29(2).
54. Contracts were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
55. Persons in the service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, in contravention of SCM regulation 46(2)(e).
56. Contracts were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43.

Expenditure management

57. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

58. Reasonable steps were not taken to prevent unauthorised, irregular, fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Conditional grants received

59. The municipal systems improvement grant allocations were not spent in accordance with the applicable grant framework, in contravention of section 17(1) of the Dora.
60. I could not obtain sufficient appropriate audit evidence that the municipality evaluated its performance in respect of programmes funded by the municipal infrastructure grant, financial management grant, municipal systems improvement grant and extended public works programme (EPWP) grant, as required by section 12(5) of the Dora.

Revenue management

61. An adequate management, accounting and information system that accounts for revenue, debtors and receipts of revenue was not in place, as required by section 64(2)(e) of the MFMA.
62. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.
63. I could not obtain sufficient appropriate audit evidence that revenue due to the municipality was calculated monthly, as required by section 64(2)(b) of the MFMA.

Asset management

64. An adequate management, accounting and information system that accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
65. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

Consequence management

66. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA.
67. Irregular as well as fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

Internal control

68. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

69. The leadership did not oversee financial and performance reporting and compliance and related internal controls. The leadership did not ensure that the review processes were implemented before submitting information, as material errors were detected in the financial statements and non-compliance with legislation and internal control deficiencies were noted throughout the audit process. As a result, there were repeat findings in the current year.
70. The leadership did not set the correct tone at the top. Senior management did not adhere to internal controls, which resulted in unauthorised and irregular expenditure not detected by management, as well as non-compliance with relevant legislation.
71. The lack of decisive action to mitigate emerging risks, implement timely corrective measures and address non-performance was evident by the failure of the leadership to adequately address the external audit findings in a timely manner. The municipality failed to properly analyse the control weaknesses and implement appropriate follow-up actions that adequately addressed the root causes.
72. The leadership did not ensure that the municipality complied with applicable legislation. Material findings on compliance legislation were raised in the year under review. The municipality's internal processes and systems did not prevent material non-compliance and irregular, unauthorised, fruitless and wasteful expenditure.
73. The leadership compiled an action plan based on the audit report findings; however, they did not adequately monitor the existing action plan to ensure that corrective actions were taken when required and within the required time frames. This has resulted in material findings similar to those of the previous year in the current financial year.

Financial and performance management

74. The leadership did not prepare regular, accurate and complete financial statements that were supported and evidenced by reliable information. In addition the collation of different information from various units for incorporation into the financial statements and annual performance report was not done in time to allow for sufficient and adequate reviews. This resulted in the material amendments to the financial statements.
75. The systems underlying the procurement processes at the municipality were inadequate to prevent and detect irregular expenditure, resulting in irregular expenditure that was disclosed in the accounting records of the municipality. Effective and appropriate disciplinary steps were not taken against officials who made and permitted unauthorised, irregular, fruitless and wasteful expenditure.
76. The underlying systems and controls were inadequate to provide reliable and accurate evidence to support the reporting on predetermined objectives. Senior management did not adequately review the actual performance against predetermined objectives reported. Therefore, sufficient appropriate evidence was not obtained for indicators disclosed.

Governance

77. The leadership did not ensure that a financial and risk unit was established. The municipality did not identify risks relating to the achievement of financial and performance reporting objectives. Consequently, controls were not developed to

prevent, detect and correct material misstatements in financial reporting and reporting on predetermined objectives.

78. The internal audit was not effective during the year under review due to instability in key positions and the availability of management. This negatively affected the audit committee's execution of some of its duties and responsibilities.

Auditor General

Kimberley

12 June 2017



AUDITOR - GENERAL
SOUTH AFRICA

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